

# How credit and its sectoral allocation contribute to long-term economic growth in Saudi Arabia

Saudi Central Bank

## Introduction

This note will unpack ongoing shifts in Saudi Arabia’s financial landscape, with a focus on credit allocation patterns and their role in sustaining long-term economic growth. To provide context, the analysis will first explore the vast changes occurring within the broader financial systems of emerging market economies (EMEs). For instance, in recent years EMEs have experienced transformative shifts in their financial systems, marked by a decreasing reliance on traditional bank intermediation and a rising prominence of capital markets and non-bank financial intermediaries (NBFIs). This evolution, partly accelerated by the Covid-19 pandemic, has altered the domestic and foreign investor base, reflecting a broader trend towards a more diversified financial ecosystem. That said, challenges arise in determining the point at which financial development becomes excessive, potentially leading to increased volatility and hindering long-term growth. Thus, identifying an optimal financial structure that minimises output volatility while maximising long-term growth is essential for EMEs, ensuring they can effectively withstand domestic and external shocks and sustain growth.

## EME financial systems: what has changed?

Over the past few decades, EMEs have undergone substantial transformations within their financial systems as a result of domestic reforms, increasing integration with the global financial system and adaptation to shifting macroeconomic trends. **A key indicator of this financial development is the expansion of private credit provided by the banking sector** (Figure 1), which accounts for approximately 123% of GDP in EMEs as of mid-2023. This represents a significant increase from 87% of GDP in 2000 and points to continuous expansion in the banking sector. However, despite outpacing their historical averages, EME private credit flows still lag behind those seen in advanced economies (AEs), where private credit currently sits at around 161% of GDP. Beyond aggregate credit growth, EMEs have also experienced a gradual but notable shift in credit flows across sectors (Figure 2), with more households and government sectors accessing the credit market. This steady shift towards expanded household and government borrowing capacity is a sign of the financial deepening, improved financial intermediation and risk appetite that has been unfolding within EME financial systems.

Figure 1 Share of credit to GDP

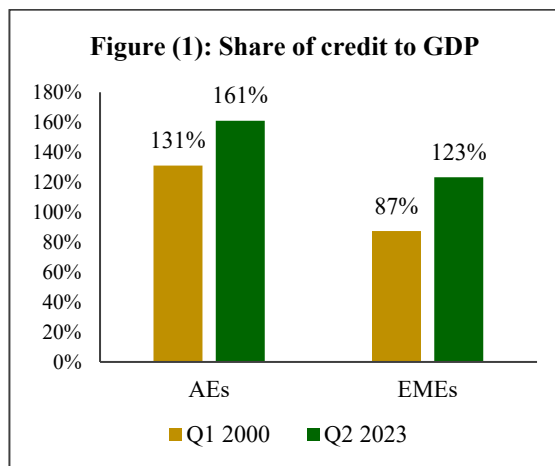
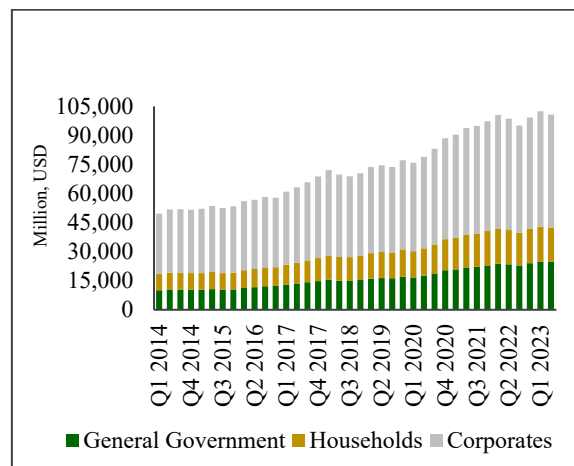


Figure 2: Credit provided by financial institutions in EMEs



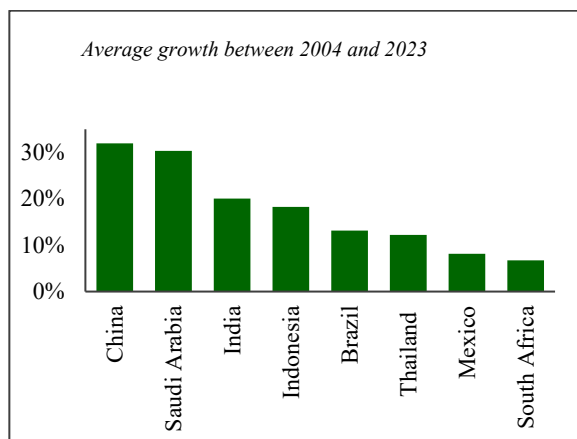
Sources: BIS data

Another important aspect of EME financial advancement is the development of capital markets, with stock market indices growing at an average annual rate of 11% between 2000 and Q2 2023. In addition, stock market capitalisation has expanded considerably (Figure 3), although it is not yet reaching the depth seen in AEs. Moreover, **EMEs have attracted growing foreign capital inflows**, as evidenced by the rise in inward foreign direct investment (FDI), which has grown at 7% annually from 2000 up to Q2 2023 (Figure 4). While this is lower than the 16% annual inward FDI growth that AEs have benefited from, it still represents substantial progress in integrating EMEs within global capital allocation frameworks. From the same graph, AEs typically exhibit higher outward FDI flows compared to EMEs. This divergence in FDI flows is due, understandably, to the fact that AEs have larger and more stable markets, superior institutional quality, a larger number of multinational corporations and more robust legal and regulatory frameworks.<sup>1</sup> Nevertheless, the sustained FDI inflows have been pivotal in transferring knowledge, expertise, technologies and managerial best practices into EME financial systems.<sup>2</sup>

<sup>1</sup> See European Central Bank, "Foreign direct investment and its drivers: a global and EU perspective", *ECB Economic Bulletin*, issue 4/2018.

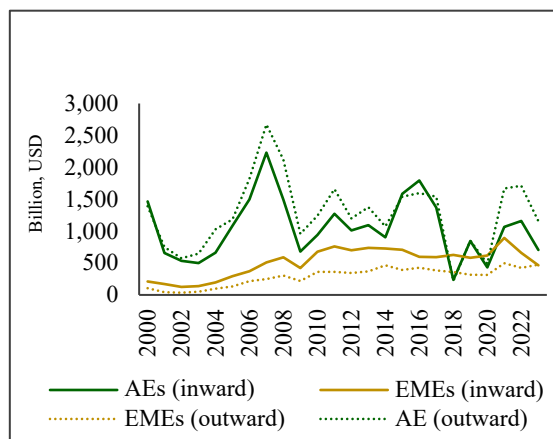
<sup>2</sup> See World Bank, *Global Investment Competitiveness Report 2019/2020: Rebuilding investor confidence in times of uncertainty*, July 2020.

Figure 3: Stock market capitalisation



Source: Bloomberg database.

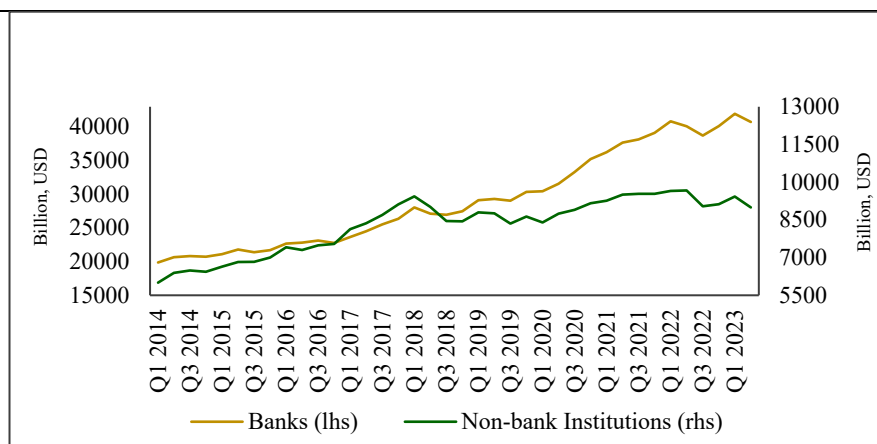
Figure 4: Foreign direct investment movements



Source: Oxford Economics.

Credit provided by banks and non-bank institutions in EMEs

Figure 5



Source: BIS data.

**One of the most transformative shifts occurring in EMEs has been the move away from traditionally bank-centric financial systems towards more diversified ecosystems**, as evidenced by the rising prominence of NBFIs (Figure 5). On average, annual credit from NBFIs increased 5% from 2014 to 2023, compared to 8% growth for bank credit. While credit provided by traditional banks is relatively higher, growth in credit from NBFIs highlights their expanding presence and potential to provide alternative intermediation. This trend towards diversification beyond banks is driven by the need for more liquid markets to attract foreign investment and for diverse financing options that expand credit access, especially for startups and SMEs.

**Another important shift, and perhaps one that cannot be ignored, is the rapid embrace of digital financial services in EMEs,** driven not only by technological advancements and increased internet penetration but also by a strategic push from governments and the private sector towards innovative payment systems. According to McKinsey,<sup>3</sup> non-cash retail transactions in EMEs grew 25% annually from 2018 to 2021, with pronounced growth in Africa and Asia as e-wallets, mobile money and real-time transfers connected more populations to the financial system. The Covid-19 pandemic accelerated this transition, driving growth in contactless payments and e-commerce activity, which sparked further digital payment innovation and adoption. However, the pace of digitalisation also poses regulatory and competitive challenges as EMEs strive to develop comprehensive frameworks aligned with complex, rapidly evolving financial landscapes. Prudent governance will be vital to manage risks while still enabling responsible innovation that can deepen access, improve resilience and unlock inclusive growth.

When discussing financial developments in EMEs, one cannot overlook the advances made in recent years by Saudi Arabia, which has seen a wave of financial enhancements across a diverse range of areas. For instance:

- **Implementation of the Financial Sector Development Program (FSDP):**<sup>4</sup>

A pivotal financial reform initiative within Saudi Arabia's Vision 2030 has been the launch of the FSDP in 2017 to accelerate progress towards establishing an advanced capital market. The FSDP outlines strategic objectives aimed at transforming the Saudi Exchange (Tadawul) into an integrated global investment platform anchored in a robust market infrastructure. Specific goals have targeted boosting market capitalisation, liquidity and value to over \$3 trillion, enhancing trading infrastructure and settlement mechanisms in line with international best practices, and facilitating seamless foreign investment access. To achieve these outcomes, the FSDP has underscored reforms across governance, infrastructure and regulation including consolidated custody and clearing frameworks, upgraded online platforms, sophisticated fintech capabilities, strengthened investor rights, improved transparency practices and greater alignment with sustainable finance standards.

- **Emergence of Tadawul as a global market:** The transformation of the Saudi Exchange (Tadawul) in recent years has been significant. Reforms aimed at aligning Tadawul with international standards have been successful, setting the stage for the landmark initial public offering (IPO) of Saudi Aramco in 2019, which emerged as the largest IPO in history. These reforms included enhancements to market infrastructure, a strengthening of regulatory frameworks and efforts to broaden market access to international investors. Such advances contributed to Tadawul's inclusion in the MSCI Emerging Markets Index in 2019, affirming its stature as a pivotal player on the global stage. That said, by 2022 the market capitalisation of Tadawul had

<sup>3</sup> See R Chaudhuri, C Gathinji, G Tayar and E Williams, "Sustaining digital payments growth: winning models in emerging markets", in McKinsey & Company, *The 2022 McKinsey Global Payments Report*, October 2022.

<sup>4</sup> See Kingdom of Saudi Arabia, *Financial Sector Development Program: Program Charter 2021*.

surged, topping \$2.5 trillion. Introducing derivatives trading on the platform has also deepened market complexity to attract institutional investors.

- **Fintech innovation:**<sup>5</sup> Since starting the Fintech Saudi programme in 2018, Saudi Arabia has worked to become a leading fintech centre in the Middle East. By 2022, this effort had helped accelerate the growth in the fintech ecosystem, marked by several new innovative startups and widespread use of digital payments. The Saudi Central Bank (SAMA) played a key role in enabling this fintech transformation through progressive regulatory policies. SAMA launched a regulatory sandbox for controlled testing of new technologies, created specialised licensing for fintech companies, and provided access to banking infrastructure and application programming interfaces (APIs) to promote development. These astute strategies are essential to driving innovation, providing legal certainty and establishing the Kingdom's position as a pioneer in regional fintech evolution.
- **Green finance initiatives:**<sup>6</sup> Aligning with global shifts, Saudi Arabia has made progress in green finance in recent years. By 2022, the Kingdom had set up multiple efforts intended to encourage environmentally sustainable investment and provide financing for green initiatives, aligning with its Vision 2030 objectives. These efforts included issuing green bonds as well as creating regulations to support sustainable finance. Through these proactive measures, Saudi Arabia has established itself as an engaged player in the global transition towards a more environmentally mindful economic model. The Kingdom's strategic steps in the emerging field of green finance demonstrate its commitment to finance sector innovation that promotes sustainability.
- **Increased foreign investor participation:** The Saudi government has actively pursued economic reforms that have targeted, among other goals, an attractive investment environment, including easing restrictions on foreign ownership and adding Tadawul to the MSCI Emerging Markets Index. These decisive actions were intended to connect the Saudi market to the global financial system, making it more accessible and appealing to international investors. Because of these strategic policy changes, Saudi Arabia has seen a substantial increase in foreign capital inflows, with 2022 marking a record year for foreign investment levels. The rising inflows demonstrate growing global confidence in the stability of Saudi Arabia's financial market.
- **Optimising Saudi debt financing:**<sup>7</sup> In 2015, Saudi Arabia established the Debt Management Office (DMO) to optimise fiscal financing costs and debt management while balancing risks and financial policies, enabling ongoing strategic access to international markets. In 2019, the DMO transitioned into the fully independent National Debt Management Center (NDMC), authorised to provide advisory services and executive plans on debt

<sup>5</sup> See Fintech Saudi, *Fintech Saudi Annual Report 2022*.

<sup>6</sup> See Public Investment Fund, *Green Finance Framework – 2022*.

<sup>7</sup> Source: National Debt Management Center.

management to government entities and majority state-owned companies. The Center's responsibilities include collecting comprehensive debt data, negotiating favourable debt terms, implementing hedging policies, managing investor relations for public debt, and securing strong credit ratings. Through the strategic creation of these dedicated institutions to oversee national debt management, Saudi Arabia has taken proactive steps to strengthen public financial governance and maintain sound fiscal positioning.

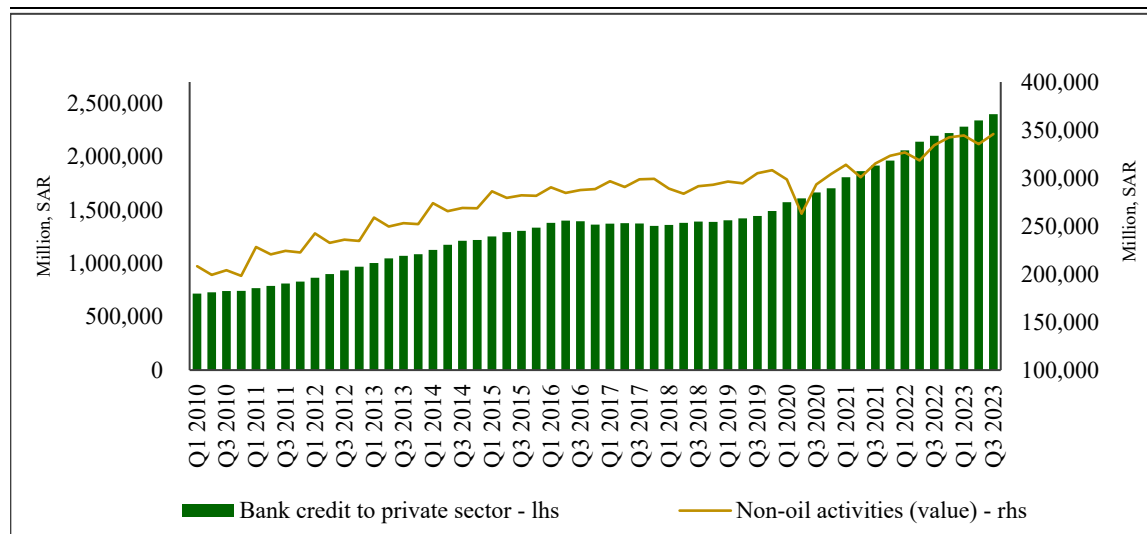
## Credit allocation and long-term economic growth

The strategic expansion and allocation of credit is foundational for EMEs like Saudi Arabia as they pursue economic diversification and sustainable long-term development. Appropriate credit growth enables investment to flow into priority sectors leading to growth and innovation, while supporting SMEs as well as consumer spending to stimulate aggregate demand. Efficient and equitable credit allocation allows EMEs to support productivity enhancements, sectoral expansion and technology adoption. In the context of Saudi Arabia's Vision 2030 programme, which centres on economic diversification and growth of non-oil sectors, the supply of adequate credit and access to financing is pivotal. Targeted lending into new industries, entrepreneurs and technology upgrades can unlock innovation, enable job creation beyond the oil sector and encourage private investment.

Looking at the credit trend (Figure 6) provides a useful initial perspective before examining credit allocation in Saudi Arabia. **The steady upward trend in bank credit to the private sector (an average of 10% annually from 2010 to 2023) is indicative of the banking system's vital role in fuelling non-oil activities.** This sustained credit expansion points to a resilient banking sector capable of financing private sector expansions while maintaining financial soundness.<sup>8</sup> The banking system's provision of financing for strategic investments has been instrumental in leading this economic transformation, with credit growth building confidence in the private sector's potential.<sup>9</sup>

<sup>8</sup> According to SAMA monthly statistics, from 2010 to 2022, on average, non-performing loans stood at 1.8%, the capital adequacy ratio at 19%, liquid assets to total assets at 22.9% and liquid assets to short-term liabilities at 36.3%. Accordingly, the financial system demonstrates soundness, characterised by well managed credit risk, a substantial capital cushion to absorb potential losses, and a sensible approach to liquidity management.

<sup>9</sup> This is also aligned with a study by M Alghfais, "Comparative analysis: the impact of financial sector development on economic growth in the non-oil sector in Saudi Arabia", *SAMA Working Papers*, WP/16/5, November 2016, published on the SAMA website.

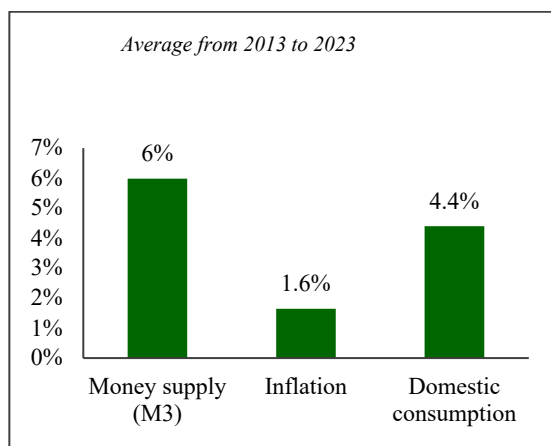


Sources: Saudi Central Bank, Monthly Bulletin; Saudi General Authority for Statistics.

Furthermore, despite the substantial credit growth from 2010 to 2023, inflation and liquidity in Saudi Arabia (Figure 7) remained stable due to multiple factors. **First**, Saudi Arabia's deep integration into global trade networks and substantial import capacity allowed any credit-fuelled rise in domestic demand to be met through higher imports rather than domestic price increases.<sup>10</sup> The Kingdom's ability to smoothly expand imported goods prevented demand-pull inflation from taking place, despite increased domestic demand from credit growth. **Second**, SAMA's fixed exchange rate regime provided currency stability, limiting risks of imported inflation. **Third**, government policies, including subsidies and price caps, further shielded consumers from potential inflationary pressures from credit expansion. **Fourth**, SAMA's proactive liquidity management ensured that increased credit growth did not undermine the financial system. By balancing the money supply with economic growth, SAMA contributed to overall economic stability while keeping inflation contained. Through these mechanisms, Saudi Arabia fostered an environment conducive to economic growth supported by credit expansion without triggering higher inflation.

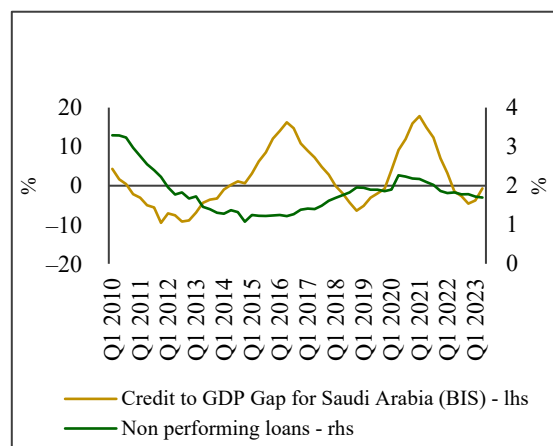
<sup>10</sup> For more details, see S Alsabban, B Alghamdi and F Alhodaithy, "Inflation in Saudi Arabia: revisiting the macroeconomic determinants", *SAMA Working Papers*, WP/2023/2, August 2023.

Figure 7: Growth in liquidity, inflation, and consumption



Sources: Saudi Central Bank, Monthly Bulletin; Saudi General Authority for Statistics.

Figure 8: Credit to GDP gap and non-performing loans



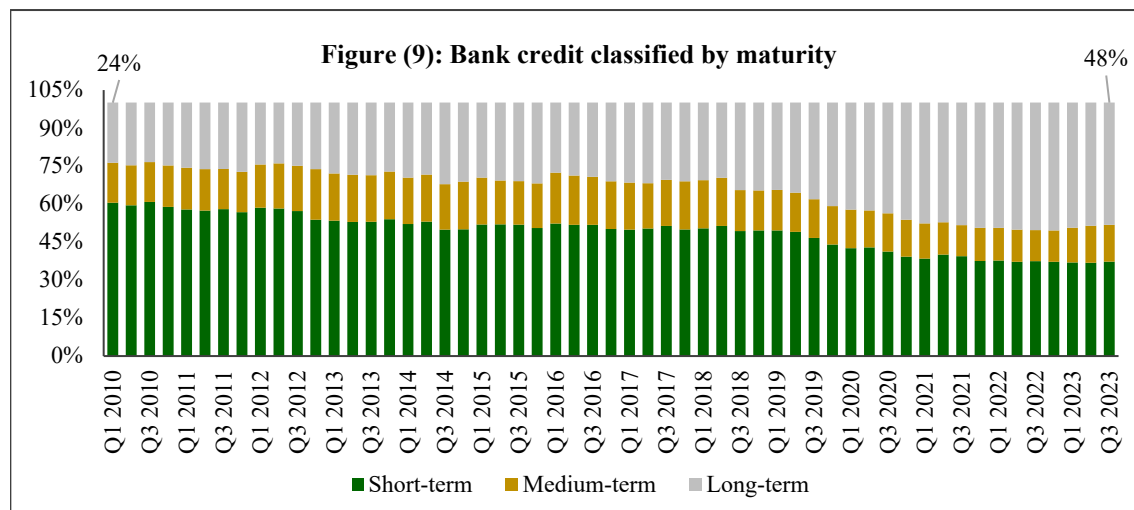
Sources: Saudi Central Bank, Monthly Bulletin; BIS data.

Looking at the credit to GDP gap and non-performing loans (NPLs) in Saudi Arabia (Figure 8) reveals that during peak periods of credit expansion, indicated by a wide credit to GDP gap, there was not a corresponding rise in NPLs. This suggests that an increase in credit availability within the economy does not lead to a proportional increase in loan defaults. Saudi banks seem to maintain the quality of their loan portfolios, possibly due to stringent lending criteria, robust risk assessment procedures and proactive loan recovery strategies, helping to keep NPLs at bay even during periods of aggressive credit growth.<sup>11</sup>

An analysis of credit distribution in Saudi Arabia by maturity reveals a structural shift towards long-term financing, indicative of strategic alignment with Vision 2030 goals. Figure 9 illustrates this trend, showing a growing proportion of long-term bank credit (from 24% as a share of total credit in 2010 to 48% in 2023). This shift to long-term maturity financing reflects a commitment to enabling large-scale, long-horizon development projects and investments critical for economic diversification. The expansion focused on long-term lending underlines the financial sector's increasing capacity to facilitate ambitious, future-oriented development. As Saudi banks allocate more long-term credit to strategic sectors, they provide a stable foundation to propel the Kingdom's economic transformation and progress.

<sup>11</sup> Similar conclusions can be found in M Al Rasasi and S Alsabban, "On the Determinants of Loan Default in the Saudi Banking System", *Applied Economics and Finance*, Vol. 11, No. 2; 2024.



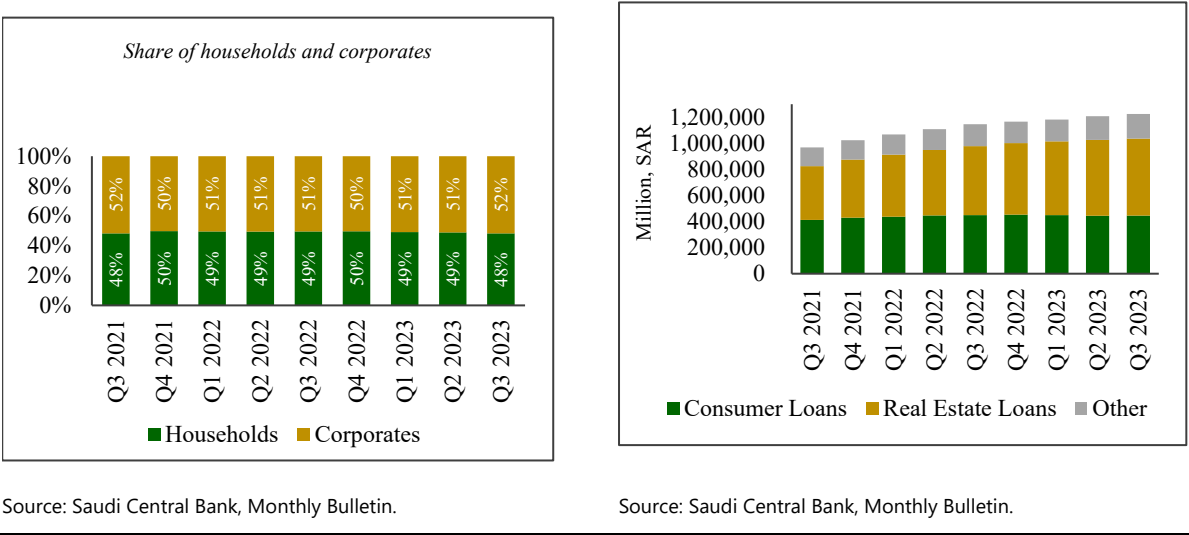


Source: Saudi Central Bank, *Monthly Bulletin*.

Further, a comprehensive examination of Figures 10, 11 and 12 provides insights into credit allocation trends between households and corporations in Saudi Arabia. Figure 10 reveals a steady distribution of bank credit to the private sector, with corporations receiving a slightly consistent share from Q3 2021 to Q3 2023. This points to steady business confidence and investment, crucial for long-term economic growth. The relatively stable household credit share indicates retained consumer confidence and access to financing for personal consumption. That said, Figure 11 shows gradual growth in the total value of household lending, especially in real estate loans, signalling an expansion in the property market (driven by government support to increase home ownership by locals). On the corporate side, Figure 12 displays increased diversification of bank credit across sectors like manufacturing, construction and others essential for sustainable economic development. This diversified credit allocation strategy supports a robust economic approach by channelling financing towards productive areas that drive economic diversification and resilience.

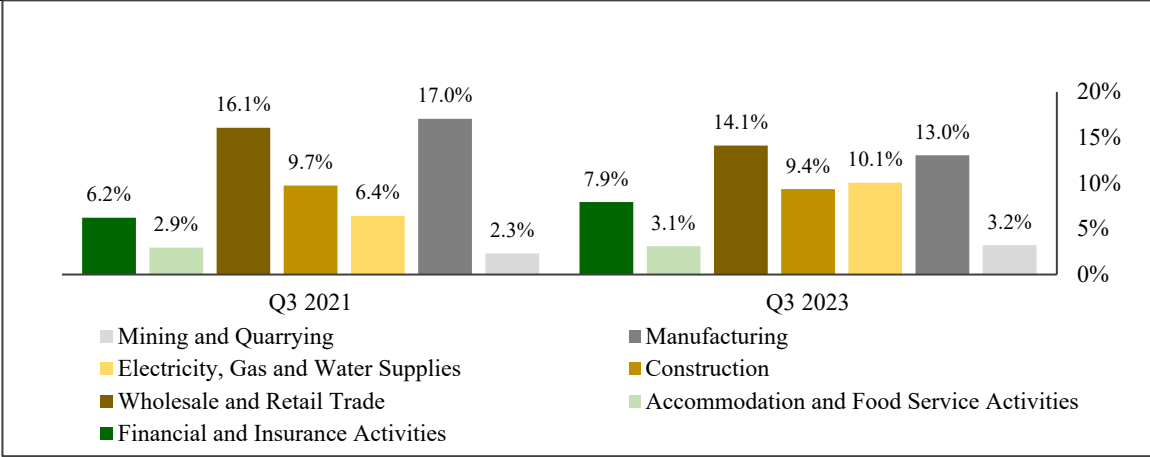
Figure 10: Bank credit to private sector in Saudi Arabia

Figure 11: Bank credit to households (value)



Bank credit to corporates allocation by economic activities in Saudi Arabia

Figure 12



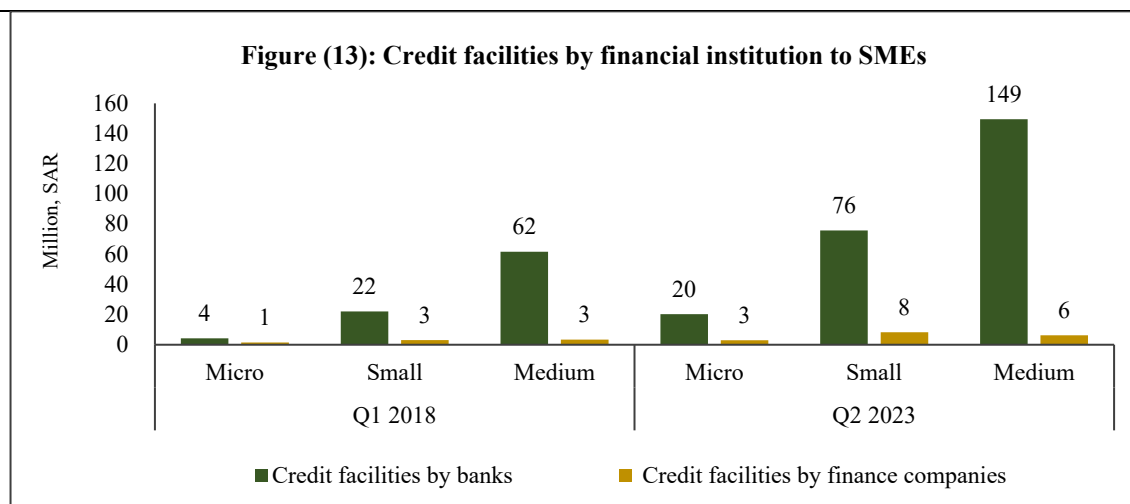
Source: Saudi Central Bank, *Monthly Bulletin*.

Moreover, the data from Figure 13 indicate a positive trajectory in the support extended to SMEs by financial institutions in Saudi Arabia. There is a remarkable increase in support for medium-sized enterprises by Q2 2023, with credit facilities from banks showing a substantial rise, indicating targeted financial support for this segment. The growth in credit facilities to medium-sized enterprises is indicative of a maturing SME sector, which plays an important role in scaling economic activities. The support for micro and small enterprises remains essential, as these entities represent an important sector within the economy often leading to new ideas and boosting local business. The data point to a strategic approach by both banks and

NBFIs to boost the SME sector, a positive sign for the overall health and growth potential of the economy. The increasing involvement of NBFIs, however, reflects a diversification in the financial ecosystem, providing SMEs with a broader range of financing options to support their business operations and expansion plans.

Credit facilities by financial institution to SMEs

Figure 13



Source: Saudi Central Bank, *Monthly Bulletin*.

In a nutshell, Saudi Arabia's approach to credit allocation is a demonstration of a financial sector increasingly advancing towards fostering a robust economy. The steady increase in private sector credit underscores the pivotal role banks play in bracing non-oil industries. Notably, the shift towards long-term financing mirrors the financial institutions' readiness to supply the capital needed for the Kingdom's transformative economic programmes. At the same time, credit support to SMEs and important industries highlights an investment in new, high-productivity fields crucial for sustainable long-term growth. With vigilant regulatory oversight by SAMA ensuring that credit expansion does not distress macroeconomic stability, Saudi Arabia's credit allocation effectively harmonises with national development goals, with banks emerging as integral players in the diversification plan.

## Policy measures

Central banks and authorities, particularly in EMEs, are increasingly recognising the vital role of digital innovation in financing long-term economic growth while mitigating emerging risks. Their primary strategy includes fostering an environment conducive to fintech development, especially in payments, which is crucial for everyday financial transactions. This strategy is particularly vital for developing economies, where bridging financial inclusion gaps is a significant challenge. That said, **central banks should balance promoting innovation with their primary mandates of financial stability and customer protection**, navigating the

complexities of new products and delivery channels that could introduce risks to the financial system.

An example of a strategic approach can be seen in Saudi Arabia, where SAMA has organised workshops focusing on digitalisation, innovation and fintech in the financial sector. These workshops aim to promote competition and innovation and strengthen the fintech sector in line with the Kingdom's Vision 2030. Initiatives like "Saudi Fintech", launched in cooperation with the Capital Market Authority in Saudi Arabia, are designed to transform the Kingdom into a significant global hub for financial technologies. Such efforts show how central banks can play a leading role in nurturing an ecosystem conducive to digital financial service innovations.

Further, more should be done by **central banks in EMEs to deepen and diversify the financial system to improve capital allocation**. An inclusive financial system, which provides comprehensive access to financial services, is essential for long-term financial security. This involves targeting market gaps and removing barriers that prevent segments in the economy from participating in the financial system. Building a comprehensive financial infrastructure, including payments, credit, savings, insurance and non-financial components like inclusive identification systems and secure internet access, is crucial in this increasingly digital finance era.

Moreover, **the Bank for International Settlements (BIS) underscores the importance of international collaboration in supporting technological capacity, enhancing cross-border payments and supporting financial inclusion**. The BIS Innovation Hub is instrumental in spearheading central banks' responses to digital innovation and fostering international collaboration, emphasising the need for central banks to be at the forefront of technology to serve society effectively.

**Central banks are also exploring the potential of digital payments and central bank digital currencies (CBDCs)**. While no major jurisdiction has issued a retail CBDC yet, many central banks have published research and some have initiated pilot projects. This underscores the growing interest in leveraging digital currencies to enhance financial inclusion and economic growth. Enhancing coordination to prevent fragmentation in cross-border payment systems is identified as a key priority, requiring concerted efforts from global financial leaders.

**Regulatory technology (regtech) and supervisory technology (suptech) are other key areas of interest** as highlighted by the BIS. These technologies are crucial for addressing regulatory and compliance requirements more effectively and efficiently. The BIS Innovation Hub's initiatives, such as the global virtual TechSprint and the development of a real-time capable market monitoring tool, contribute significantly to the regtech and suptech agenda, demonstrating the pivotal role of technological innovation in advancing central banking and financial supervision.

In conclusion, central banks and authorities can enhance long-term economic growth by fostering equitable credit distribution and digital innovations while ensuring financial stability. This involves creating a conducive environment for fintech development, focusing on inclusive financial systems, leveraging international collaboration and exploring emerging technologies like CBDCs, regtech and suptech. These efforts will collectively contribute to a more robust, diverse and efficient financial system, crucial for sustainable economic growth and development. Central banks can also improve capital allocation by expanding the diversity of financial instruments and ensuring inclusive access. All individuals and enterprises, especially

underserved groups, should have access to and usage of a full range of credit, financing, payments, savings and insurance solutions tailored to their needs. Thus, central banks must identify and eliminate market gaps and barriers that prevent equitable access. Robust financial and non-financial infrastructure including digital IDs, internet access and digital finance solutions is crucial for enabling inclusive systems. The focus should be on outcomes – stability, resilience, wealth creation and economic mobility for all.